DOW THEORY LETTERS INC.

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36 Letters per Year – $75 Annually

Registered with the Securities Exchange Commission

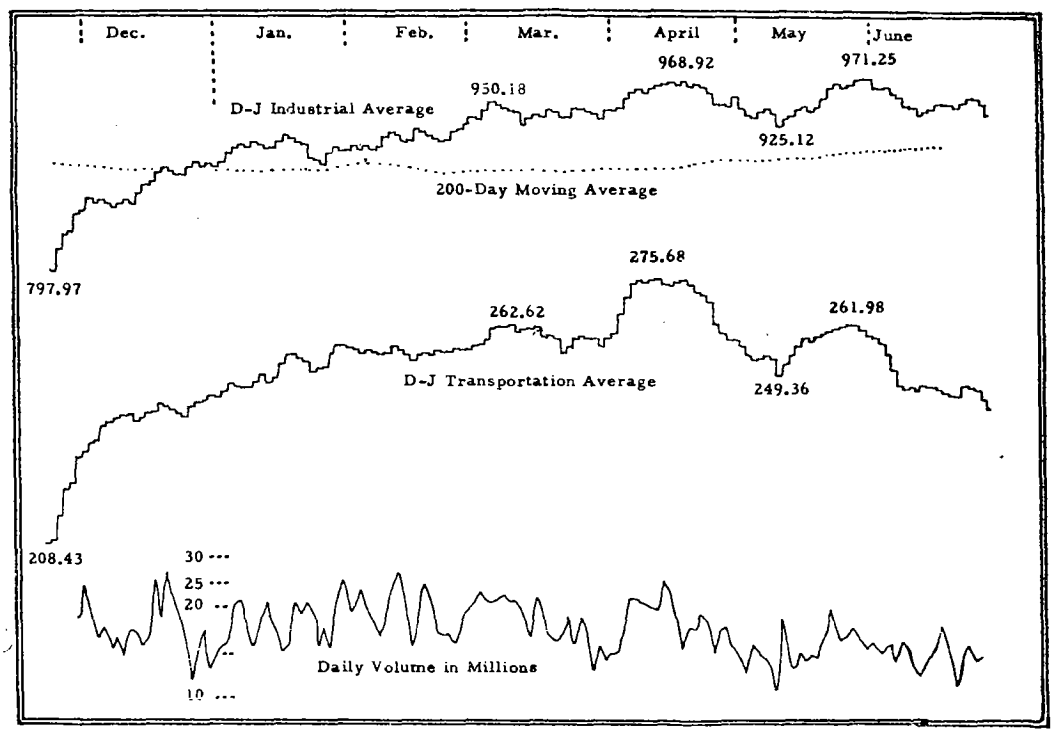
June 28, 1972 Letter 533

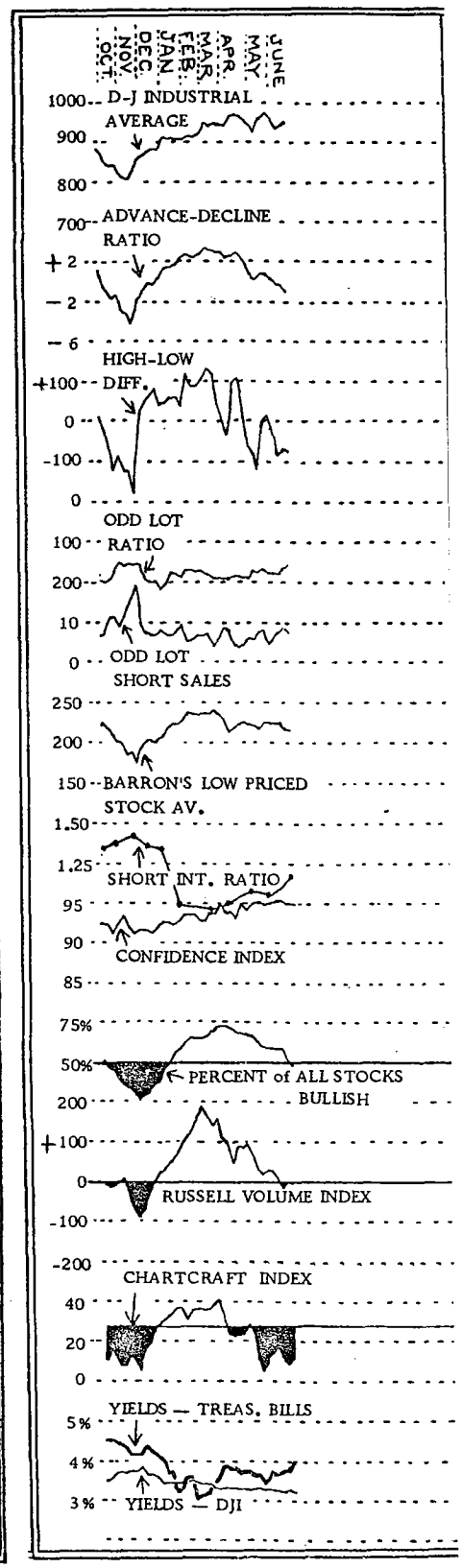
THE MARKET: The market is always "telling a story." Millions of speculators and investors, amateurs and professionals listen to their own pet theories, listen to their advisors, their brokers or their research staffs. But few, very few, listen to the market itself. Yet the real story, as the great Dow Theorist, Robert Rhea, was fond of saying, is always in the Averages, if only we possessed the wisdom and intuition to interpret the Averages correctly.

The Dow Industrials closed at 931 on the first trading day after Mr. Nixon assumed the office of President. In the years since then, the Dow has been as far as 300 points below the 931 level (i.e., down to the 1970 level of 631), but the Dow has never been substantially above the 931 level. I would guess that this fact haunts our good President and may, in part, be responsible for his belated journey down the primrose path of inflation.

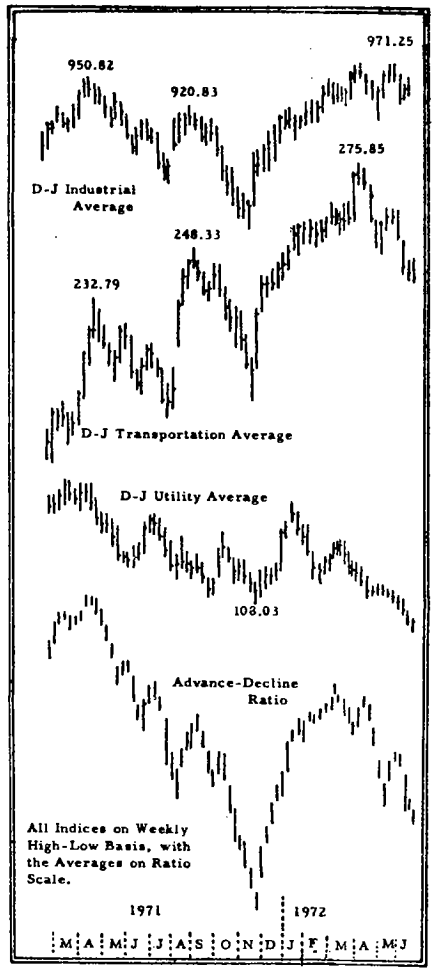
On January 11, 1972, the Dow Industrials recorded their January high of 912.10. In the five months since then, the Dow (at its best) has managed to advance only 59 points above the January peak closing. Although the January to June action represents a weak performance on the part of Industrials, the action of the Transportation Average has been considerably weaker. Last week the Transports broke to a new 1972 low. Not to be outdone, the Utility Average last week sank to a 1972 low of its own. All of which prompts us to ask, "What kind of a story are the D-J Averages telling as we head into the second half of 1972?"

The fact is that the Averages have been doing little or nothing throughout the year 1972. When the performance of the market is apparently "out of gear" with the expectations, that is the time when the market barometer is fulfilling its most important function. For despite the daily supply of happy new economic statistics, promises and projections, it is becoming increasingly obvious that the Averages have been looking "elsewhere" for their stimuli and direction.





Personally, I can only offer my own guesses as to what is going on beneath the market's surface. For instance, could the Vietnam War be coming to an end? Has the market already discounted this, and could the sideways action of the 1972 market represent a giant distribution based on the coming good news? Or, are Senator McGovern's chances for the Presidency better than we think? Is the groundswell of American discontent far greater than anyone realizes, and is McGovern (the financial maverick) nearer the Presidency than we can believe? Or, are the US's finances much worse than even the pessimists suspect? Are "higher taxes" in the bag for 1973, taxes which could literally curl the hair of the already overburdened American citizens? Or are we on the threshold of another world monetary crisis, set off this time by the current floating of the pound sterling or by perhaps a forthcoming devaluation (yes, I said devaluation, not revaluation) of the German mark? Has the massive rise in the price of gold bullion been the "moving finger," the sign which has been writing "finis" to the US's leadership role in world monetary affairs? To all of these we can only answer, "time will tell."

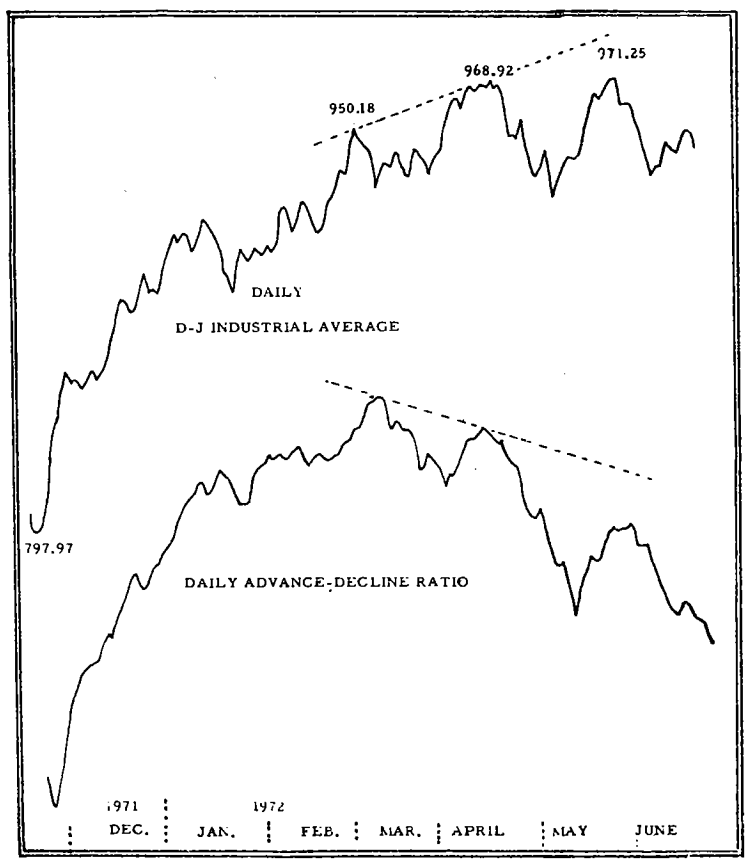


At any rate, the Transportation Average struck its 1972 peak on April 12 at 275.85 (see page 1 chart), while Industrials recorded their 1972 peak on May 25 at 971.25. Since then the general deterioration (which I have been writing about since April) has broken out into the open, and most of the stock purchases of 1972 have dwindled away into losses.

Suddenly the technicians are setting up their trendlines, the pundits are announcing that massive "support" lies at the 920 or 900 level, and increasing emphasis is placed on the sprightly business picture. The "Dow 1000 or 1100" which Treasury Secretary Connally promised earlier in the year now seems more fantasy than reality; the predictions have "exited" from the scene along with the Treasury Secretary himself.

Glancing at the page 2 weekly chart of four leading indicators we can observe the relative "holding action" of the Dow Industrials as against the distinct downtrends in Transports, Utilities and the advance-decline ratio. Last week, as previously mentioned, the last three mentioned indicators broke to new 1972 lows, and it is now obviously a question of how long Industrials can hold out against the ominous deterioration in the rest of the market.

Turning to the second chart, which traces the daily action of the Dow and the A-D ratio, we see what I have been warning about for the past few months. Here is the dangerous "triple divergence" between the Dow and the rest of the market as measured by the A-D ratio, a rare formation which has almost always led to serious trouble in the past. For some incredible reason, literally no other advisory service has identified or discussed this classic structure, most having elected (if they noted anything wrong at all) to mention something about the A-D ratio being "weak" in the current market.



True to form, the triple divergence has given way to severe downside pressure on the mass of Big Board issues, and as seen on the chart, the A-D ratio recorded new 1972 lows all through last week. This gathering weakness is further documented in the "High-Low" section of this Letter. Finally, I might add that the A-D ratio has now collapsed to its mid-December, 1971, level. If the Dow were to sell at a comparable level, it would be down to the 880's.

OTHER TECHNICAL NOTES: The latest Dow short interest ratio (see Letter 531) for the mid-May mid-June period has just come in from Bill Gordon of New York. With the total short interest in the 30 Dow Industrials rising slightly from

443 to 458 thousand, the ratio rose very slightly to .40. The three month moving average of the DSIR is at its lowest level in history, and the prognosis is bearish, very bearish.

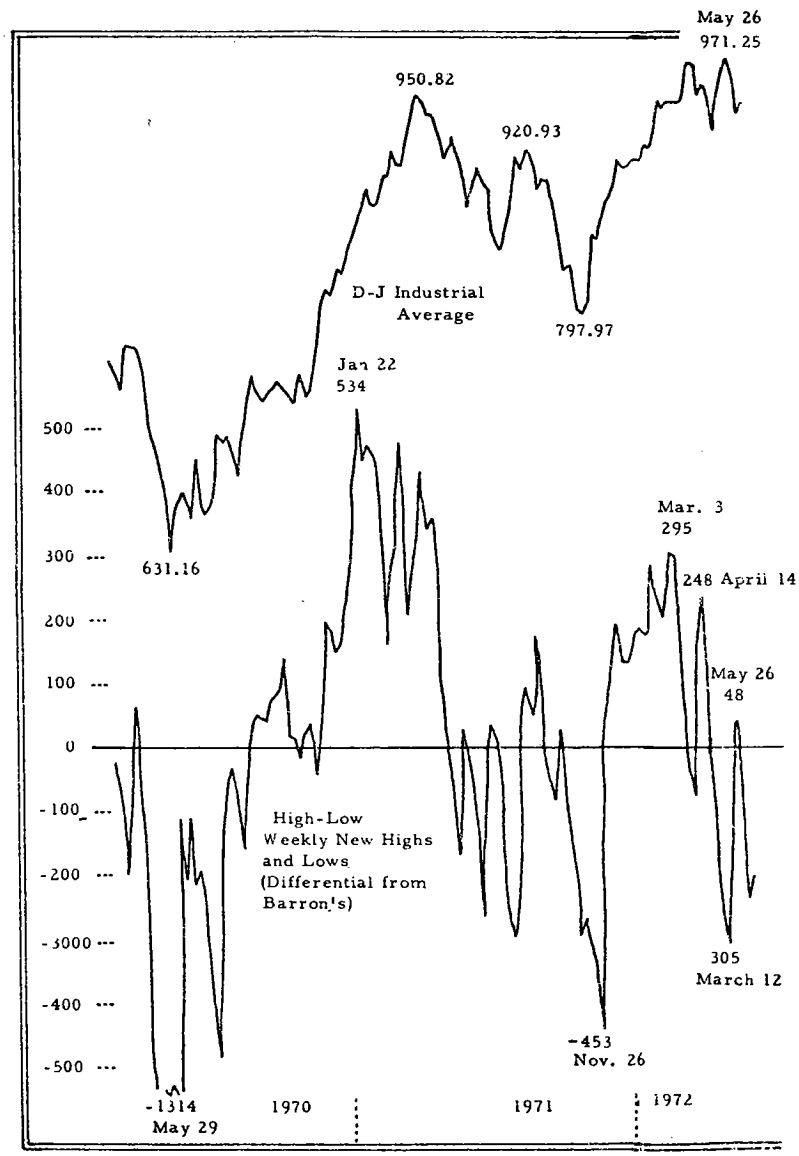
As seen on the page 1 chart, the percentage of all stocks in bullish trends on the NYSE (see Letter 521 study) dropped to 49.5% on June 19, the first drop under the critical 50% level in 1972. This is a bearish development (statistics courtesy of Chartcraft, Larchmont, NY 10538).

Treasury bill yields are climbing (see page 1 chart) and the latest reading is at the 4% level. This trend must be taken negatively for the stock market.

As underscored in the last Letter, the critical point for this market is now the Dow Industrial level of 925.12 (recorded May 9). A penetration of this level would constitute a confirmation of the successive new lows in the Transport Average and would (in my opinion) signal major trouble for the stock market, the business outlook and Mr. Nixon's chances of re-election. I believe the odds for the Dow breaking the 925.12 level are excellent.

HIGH-LOW STUDY: I am including my chart of the weekly new high-new low differential, figures for which are taken from Barron's. This chart simply plots the plurality of new highs or new lows each week. For instance, if there are 300 new highs for a given week and 100 new lows, the figure plotted would be a plus 200.

This graph provides excellent indications of the underlying strength (or weakness) of the market, and the rational behind the high-low index is both simple and fundamental. During an advance, the ongoing upward strength will take many stocks to new highs for the year. If the advance is widespread and has substance, more and more issues will join the "new high parade" and all the while the new highs of previous weeks will continue going up. Thus the high-low index will expand strongly as it did in late 1970 (see chart). But if the advance is selective, fewer and fewer issues will push to new highs, and the Averages will move upwards on the strength of a decreasing number of high-flying issues. This represents technical weakness. The same rationale applies in reverse during a decline.

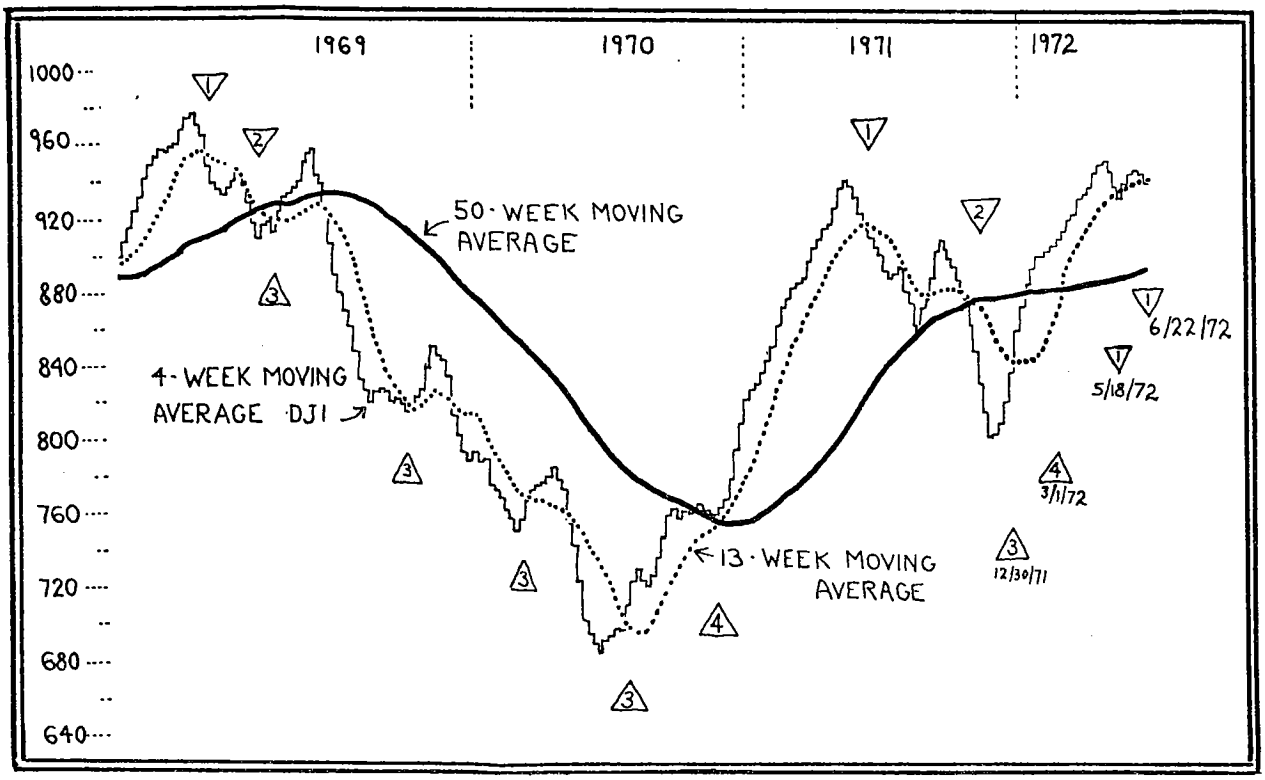


Now, as to the actual market, note that the index touched its peak of 534 on January 22, 1971. Three months later, in April, the advance-decline ratio topped out, and the ratio has not yet bettered that early 1971 peak (see Letter 531). Thus the high-low index proved to be an early but remarkably accurate indicator of approaching weakness.

Following the early 1971 peak, the market went into a long decline, and the high-low index set a November 26, 1971, low of minus 453. That proved to be the peak of weakness for the past two years.

Next came the 1972 experience. The market advanced with the high-low index recording its peak on March 3 at plus 295. That same week the Dow closed at 943.43. The Dow then rallied to an April 18 peak of 968.92. A few days before (April 14) saw the high-low index touch a peak of 248. A decline ensued, followed by a Dow rally to a May 26, 1972, recovery high of 971.25. Here, it is startling to note that the high-low index registered a feeble plus 48 (May 26). Obviously, with this type of technical non-confirmation from the high-low index, the advance could not continue.

A new decline got underway, and this time Transports, Utilities and the A-D ratio dropped to new 1972 lows, with the high-low index reaching a minus 201 on the week ending June 16, 1972. From here on, it will be well to scrutinize the high-low index, particularly as to whether it picks up momentum on the upside or the downside. So far, all advances have been accompanied by decreasing or substandard readings on the high-low index. No legitimate advance can progress very far in the face of this kind of technical deterioration.



MOVING AVERAGE: Subscribers know that we follow a series of three moving averages of the D-J Industrials. These are the 4-week MA, the 13-week MA and the 50-week MA. Upside penetrations of the 4-week through the 13-week are termed number 3 signals, and are preliminary bullish signals. Major bullish signals under this study occur when the 13-week MA moves above the 50-week MA, and these are referred to a number 4 signals.

Preliminary bearish signals (number 1) result when the 4-week MA drops below the 13-week MA. And major bearish signals (number 2) when the 13-week MA plunges below the 50-week MA.

In Letter 523 (March 10) attention was directed to a number 4 bull signal (see chart). This was set off on March 1 when the 13-week MA moved above the 50-week MA. I advised caution on this signal, however, since I stated that number 4 signals within primary bear markets (as I believe this one is) should never be accepted with the same bullish attitude that they should be accepted with if they occur in a primary bull market.

On May 18 this study provided a preliminary bearish signal (a number 1 signal) as shown on the chart. This occurred when the 4-week moving average (MA) sank below the 13-week MA. The 13-week MA was rising quite rapidly at the time, and this made me think that the signal would not take effect immediately.

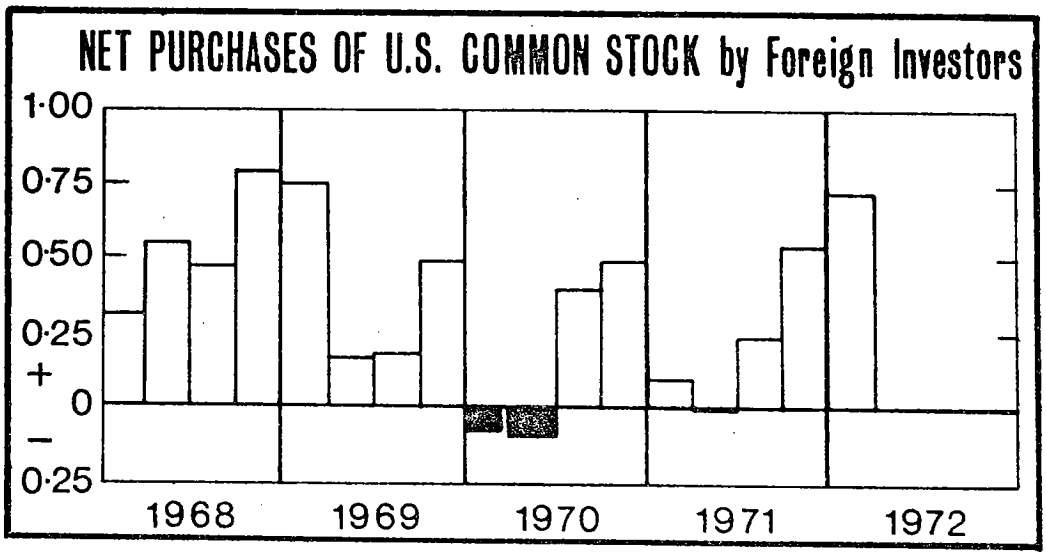
The 4-week MA then rallied above the 13-week MA again, although, as we can see on the chart, the Dow was not strong enough to take the 4-week MA above its high for the year at 969. Last week (June 22) the 4-week MA dropped below the 13-week MA for the second time. This second number 1 signal has occurred while the 13-week MA has flattened out (it has not moved up in the past month), and it will be interesting to see whether this second number 1 signal will be the harbinger of lower prices ahead.

In other words, a factor to consider here is the recent power or "upward momentum" of the 13-week MA. As you can see on the chart, the 13-week MA rose strongly from January, 1972, through to May of this year. Only recently has this momentum ebbed, and the second downside penetration of the 4-week MA has occurred as the upward momentum of the 13-week MA became obvious and visible.

This recent action is in contrast to the 1968 series (see chart) when the initial number 1 signal occurred as the 13-week MA was already heading down. That downside penetration led to a very rapid weakening of the entire market structure. As things stand

now, the 1972 structure could require more time before starting to unravel.

More time would allow the 13-week MA to roll off its current horizontal path and head down. If this occurs, and if the 4-week MA positions itself below the 13-week MA, I would guess that the odds favor lower prices throughout the remainder of 1972. I will continue with this study in forthcoming Letters.



FOREIGN TRANSACTIONS: Much is made of the common stock transactions of foreigners. Americans seem to think that foreigners have some mysterious "feel" for the market which they lack. Perhaps this stems from the Swiss mystique ("All foreign stock buyers are really Swiss geniuses who know how to do nothing but make money").

When we examine the facts, we learn that nothing could be further from the truth. The accompanying chart shows the quarterly new purchases (or sales) of US stocks by foreigners (chart courtesy of Stock Market Alert, 189 de la Warr Rd., Sexhill-on-Sea, Sussex, England). Note that over the past five years, the two heaviest quarterly purchase totals occurred during the last quarter of 1968 and the first quarter of 1969, just prior to and during the worst US stock market collapse since 1937!

Then to make matters worse, foreigners produced net sales during the first two quarters of 1970, just before and during the final bottom. Buying picked up during the last two quarters of 1970, dropped substantially during the first two quarters of 1971, and then rose throughout the rest of 1971.

Now here is the interesting and up-to-date part. We now know that the advance-decline ratio topped out in April, 1971. After that time the real "gravy" of the advance was over, and it became progressively more difficult to make money in this market. Despite this, buying picked up substantially during the last quarter of 1971. And the first quarter of 1972 saw the heaviest foreign buying since the beginning of 1969 (it was the third heaviest net buying quarter in history).

I believe that the almost $600 million in foreign stock buying during first quarter 1972 is liable to prove to be just as wrong as it was during early 1969. We know that the advance-decline ratio topped out on March 9, 1972, and that the great majority of Dow stocks are now lower than they were during their April, 1971, highs. It is therefore doubtful whether foreigners are showing profits on their 1972 purchases. And before the year is over, they may be showing losses.

Undoubtedly a great deal of the foreign money moving into the US market is from foreign dollar holders who want to get out of dollars and into something else. How ironical it would be if these same inflation-depreciated dollars were to move into stocks which were to depreciate in a declining stock market. But then, nobody ever promised that those dealing with a US which is hell-bent for inflation would have an easy time of it.

GOLD & MONEY: It is becoming clear, even to Washington, that the US is not calling the international money tune any longer. A week ago the powerful Bank of International Settlements of Basel in a report warned that if the dollar does not soon become convertible, other nations will vote controls on dollars and the world will break up into separate trading blocs.

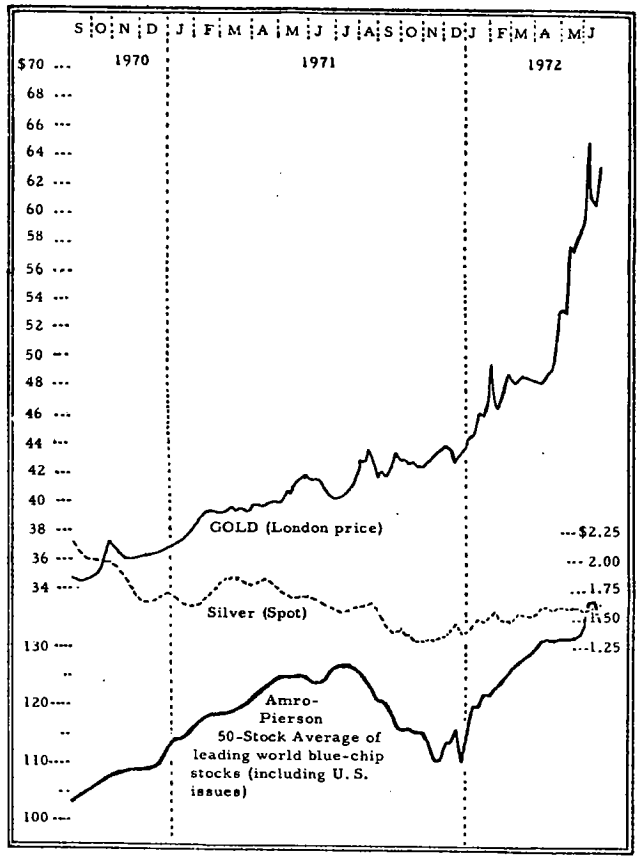
On a different but related front, the Trudeau government of Canada (which has long had close relations with Russia) reported that "with or without the blessings of the US, Russia will soon announce that her ruble will become convertible into gold." This is a long standing prediction of mine, and it is one of the aces in Russia's economic battle for supremacy. Imagine a convertible ruble

and a fiat dollar! Well, we're very close to just that. In the meantime, with no improvement (so far) visible in its trade balance, the US (which is rapidly becoming the "sick ·en of the world") could wind up 1972 with a trade deficit of $6 lion.

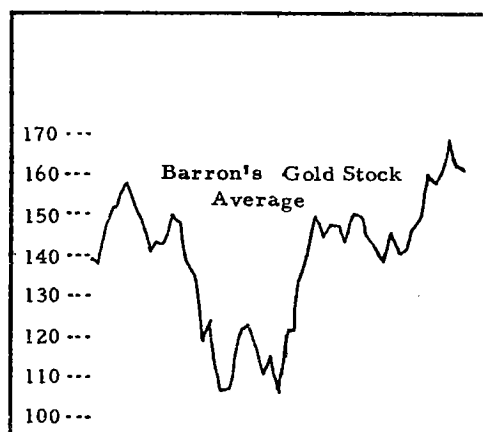
Friend Harry Schultz in his latest report (Box 45, Rheindfelden, 4310 Switzerland) states that he sees a deal impending wherein Russia sells "X" percentage of its gold output to the US in return for long-term dollar credits to be used for buying needed capital goods. Of course, the Russian gold would be sold to the US at a new and much higher-than-present price.

But remember, no deal on gold at any price will save the US from producing efficiently and competitively. Nothing like the current US trade deficits will be tolerated by the rest of the world, and this is a problem which Mr. Nixon will have to deal with (I suppose he will toy with this after the election).

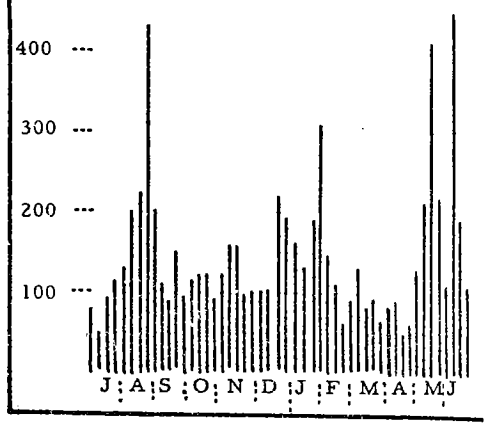
I am including my chart of Barron's Gold Average and the weekly total volume in the four listed gold stocks. My conclusion is that despite a huge rise in the price of both gold shares and the Gold Average during 1972, gold volume has been anything but spectacular. The inference is that the professionals are buying the gold shares, not the public. But the public will buy gold shares in time, when it finally dawns on them that they have been fed a diet of rubbish, rot and hypocrisy from Washington lo these many years regarding gold.



The regular gold-silver metal chart shows the bullion price of gold heading up to its high closing of a few weeks ago, and even silver is firming, reaching und $1.62 this week.



Weekly volume in Campbell Red Lake, Dome, Homestake and Amer. S. African
(Volume shown in thousands)



THOUGHTS: Many newer subscribers probably believe that I sit out here in La Jolla (known to many as the "Jewel of the Pacific") and occupy perhaps 20 out of every 24 hours in pondering the mysteries of Wall Street. Now the fact is that there have been times when I have done just that. But man cannot live by stock fluctuations alone. There are greater mysteries to be pondered, of which Wall Street is only one.

For instance, it is dawning on me after many decades of thinking about it, that perhaps 95% of the world's citizens are emotionally "dead." They do not possess any real contact with their inner selves, their "core," and as they are cut off from the greatest source of world power, the connection with their deepest selves which in turn is connected with the infinite, the supreme power or, if you will, God.

In my younger and more ignorant days, I fancied myself an atheist. Then I became an agnostic. Later I felt a passing interest in a supreme or infinite power. Most recently, due to many factors and dramatic incidents in my personal life, I have become convinced beyond a shadow of a doubt that there is a supreme and infinite intelligence which guides the life of man and the universe.

The connection we have with that infinite intelligence, I firmly believe, is in the connection with our deepest selves. Only those who have this connection possess the ability to love, and I consider this ability to be the greatest t given to man. I believe that if man is ever to achieve happiness on earth, he will have to delve deeply into his own psyche and soul (each in his own way) in order to unearth his God-given ability to love. Against such forces, the fluctuations of the stock market are but ripples in the sands of time. I wrote this because I do not like the market to take over my life (as it once did). The market is part of my life, but I feel I see the stock market in better perspective now than I did when it was the biggest thing in my day or night.